M Capital Group




U.S. ECONOMIC OUTLOOK

“Being Decided”

August 2021

M Capital Group

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Our Word is Our Bond

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SYNOPSIS

Where do we head from here?

The Covid-19 pandemic was an unprecedented and major economic shock worldwide. However, as James Bullard, president of the Federal Reserve Bank of St. Louis, said: the U.S.'s recovery from that shock "surprised us all." The recovery has been incredibly positive, as evidenced by economic indicators such as real GDP steadily growing at 6.5%, and it has been fueled by continuous fiscal and monetary stimulus in the major economies such as the U.S. and China.

Seas remain high, though, and it is not all smooth sailing ahead.

Certain indicators such unemployment, interest rates, and inflation, have remained somewhat troublesome. In addition, there are turbulent risks on the horizon, including the rocky U.S.–China trade relationships, recovery challenges for emerging markets, geo-political tensions in the Middle East and Russia, and re-appearing political/economic obstacles in Latin America.

All this is complicated by the stubborn, seemingly uncontrollable and resurgent Covid-19 waves from ranging from Delta, to Alpha, Gamma (and who knows, we might even run out of further Greek letters), notwithstanding vigorous vaccinations in the developed world.

In the immediate short term, we remain confident in an economic environment of abundant liquidity, while subdued and cautious about inflation, the possibility of stagflation, market exuberance in IPO's and SPACs, and another threat of a massive wave of Covid-19 that would reinstate mobility restrictions.

MAIN DRIVERS

Looking at the main drivers of economic growth, inflation, monetary and fiscal policy, and international trade, we try to read what is ahead for us.

Major Economic Recovery After Gloomy 2020

In 2020, the U.S. experienced a deep economic recession and a significant increase in unemployment because of Covid-19 lockdowns, business interruption, a gyrating stock market, and related disruptions caused by the pandemic. However, in 2021, the U.S. economy is bouncing back; real GDP has increased 6.4% already in Q1 2021 and the unemployment rate has decreased 5.2% between June 2020 and June 2021. This growth is supported by continued economic recovery, the reopening of businesses, the lift of mobility-limiting restrictions, and government stimulus, which has boosted personal consumption expenditures.

In this transition back to "normal life" without restricted mobility, employment is increasing as people rejoin the workforce and make their way back to an in-person workplace. The total nonfarm payroll employment rose by 850,000 in June 2021, and the unemployment rate was little changed at 5.9% M-o-M, which considerably decreased from recent highs in April 2020 but remain higher than the pre-pandemic level of 3.5%. Sectors that were hurt most by pandemic restrictions (i.e., leisure and hospitality, public and private education, professional and business services, retail trade, and other services) are experiencing notable job gains as consumers have started to draw down their significant savings in 2020 to spend on in-person services that were not available during the pandemic.

Inflation Spike as a Temporal Shock

In order to help alleviate the economic cost of Covid-19 for businesses and individuals, the federal government enacted robust fiscal policies, including two relief packages. This helped boost the U.S. economic growth and recovery but caused a surge in inflation rates. In 2020, inflation was relatively low, at a rate of 1.2% for the entire year. As of June 2021, the M-o-M inflation rate is 5.4%, which is the highest rate in nearly 13 years, amid a dramatic increase in used vehicle costs and price increases in food and energy. However, Federal Reserve policymakers and many economists believe such inflationary pressures are primarily transitory and influenced by base effects from abnormally low rates during the pandemic. As a result, the target fed funds rate was maintained at a range of zero to 0.25% at the recent meeting in June 2021; however, a Fed report indicated that upside risks are increasing and it is expecting the first interest rate hike to occur in 2023, rather than 2024, as it indicated in March.

Monetary and Fiscal Policy Fast Rebound - Despite Concern about Excessive Level of Public Debt

During 2020, to contain the negative economic effects of the Covid-19, the Fed increased the money supply (M2) by around a fifth, bought short-term and long-term government bonds, and acquired company debt. The decisive actions of the Fed have helped to keep interest rates low and allow the stock markets to recovered in 2020 from their initial fall. Substantial fiscal stimulus, namely the $2.3 trillion Coronavirus Aid, Relief and Economy Security Act (equivalent to around 11% of GDP) in 2020, also helped support the U.S. economy and attributed to a fast rebound in 2021. This is despite a 23%-point rise in public debt to 131% of GDP in 2020, signaling that the U.S. economy may not register robust growth when the economy goes back to normal in the absence of huge fiscal stimulus.

International Trade Revamp

As the pandemic surged, the U.S.-China trade war showed no sign of abating. Although President Biden signed a flurry of executive orders in his first weeks, the new administration has been cautious about overhauling his predecessor's tariff-heavy trade policy. And the President has kept the Trump-era tariffs in place, presumably to use as bargaining chips in future trade negotiations. Businesses are likely to respond to the ongoing trade policy volatility by, for example, reducing their dependence on a single source of foreign suppliers, particularly Chinese suppliers. This may increase inflationary pressures as low Chinese prices have held inflation in check for many years.

Prospects: The New Normal Under Several Uncertainties

According to the IMF, U.S.'s real GDP growth is expected to stand at 7% in 2021, the strongest in over a decade, and continue to its growth at 4.9% in 2022 as an unprecedented fiscal and monetary stimulus and a rapid vaccination campaign have supported an economic rebound. Savings will be drawn down, demand will return for in-person services, and depleted inventories will be rebuilt after fixing bottlenecks in supply chains. The increase in employment and the labor force are also signs of positive recovery and could help lesson wage and price pressures. Inflation expectations are also expected to remain well-anchored. However, renewed waves and new variants of the virus spreading in the unvaccinated population pose certain uncertainties to the outlook.

This report examines the current data available about the U.S. economy and compares it to the same metrics in pre-pandemic and pandemic time periods in order to evaluate the strength of the economic recovery and predict future trends. Data points of important economic indicators, such as real GDP, inflation, interest rates, consumer spending, and unemployment rates, are used to show the numerical growth of the economy, while social and political factors put this growth in context.

U.S. ECONOMIC CONTEXT

Introduction

The Covid-19 pandemic had significant and unprecedented impact on lives across the country. January 2021 was the deadliest month, when an average of 3,100 Americans died daily of Covid-19. As of July 2021, over 600,000 Americans have died, and the average life expectancy of all Americans has fallen. However, a diligent rollout of vaccination programs over the past several months has begun to bring the pandemic under control. By July, 50% of the eligible population had been fully vaccinated, and both new cases and the test positivity rate have fallen substantially.

As the pandemic dies down, there is hope for a robust recovery in the U.S. economy. After restrictions on mobility and businesses were lifted, the economy has reopened, and consumer confidence has continued to increase. Private spending, particularly spending on in-person services, is expected to help drive the recovery forward. This driver will be supported by a strengthening labor market and a large pool of savings from three rounds of fiscal stimulus checks dispersed over 2020. In addition, a new wave of monthly government checks to families with children, worth more than $100 billion, was launched on 15 July 2021, which should further strengthen customer spending in 2H 2021.

With this rapid acceleration in growth seen in early 2021, consumers are experiencing rising prices and economists have heightened concerns about inflation. According to Euromonitor, inflation is expected to peak in Q4 2021 and likely to remain elevated into early 2022, before beginning to moderate. The Fed is expected to tolerate these transitory price increases and continue with planned monetary expansion.

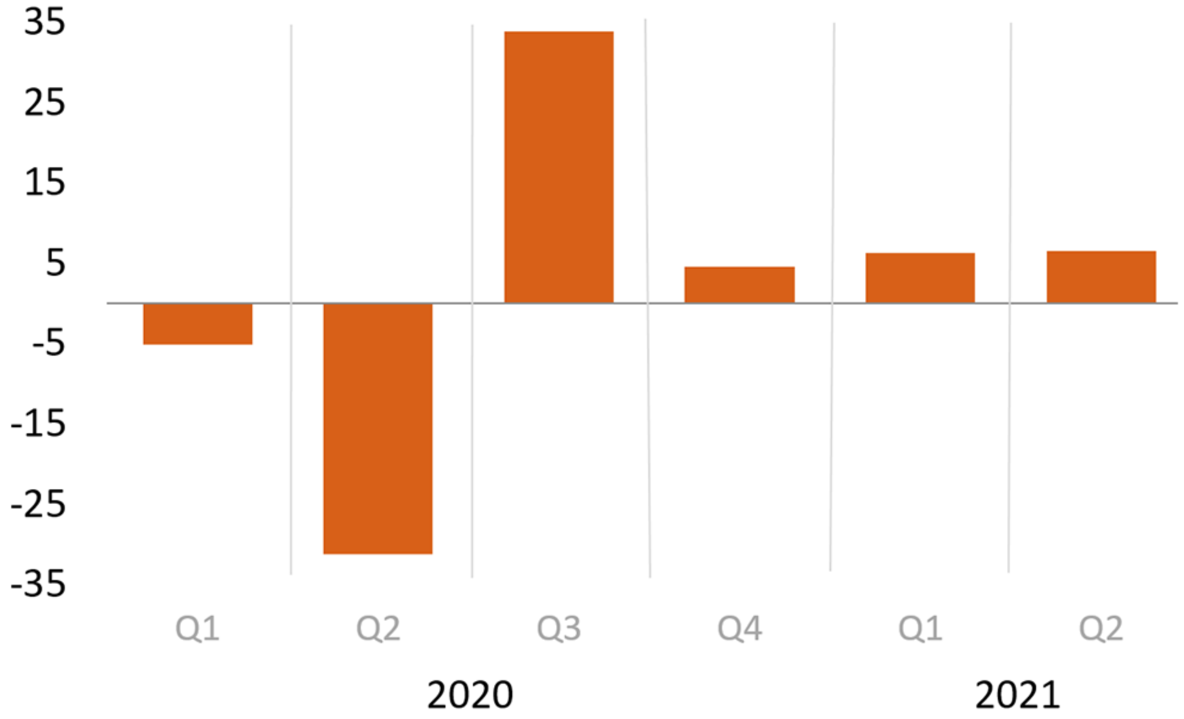
Finally, it is likely that another large round of government spending may be underway– although the size, composition, and timing remain uncertain. While a bipartisan infrastructure deal worth $1.2 trillion was struck in June, the Democrats may press forward on a larger reconciliation bill to supplement, or possibly replace, the negotiated package. However, even if passed today, it is unlikely that the package would impact the U.S. economy until 2022.

Current Economic Environment

GDP Bouncing Back

The Covid-19 pandemic caused the U.S. economy to enter a dramatic recession because of lockdowns that shut down businesses and restricted mobility, rising uncertainty of consumers which were reflected in stock market crashes, and major labor and supply chain shortages. This shrinkage is reflected in the country's drop in real GDP in Q2 2020 of 31.4%. However, the U.S. has shown great speed in recovery; as quickly as real GDP dropped, it rose again the next quarter by 33.4%. In late 2020 and early 2021, there has been a more conservative increase in real GDP, which increased by 6.4% in Q1 2021, prompted by a robust mass vaccination rollout and federal stimulus, e.g., stimulus checks and tax credit, which boosted consumer spending. There are no signs that this growth will stop anytime soon. The U.S. economy has increased back to pre-pandemic levels at a remarkable rate, and it recorded a 6.5% increase in real GDP for Q2 2021.

US Real GDP Percent Change from Preceding Quarters (In Percent)



Source: MCG, Bureau of Economic Analysis, July 2021

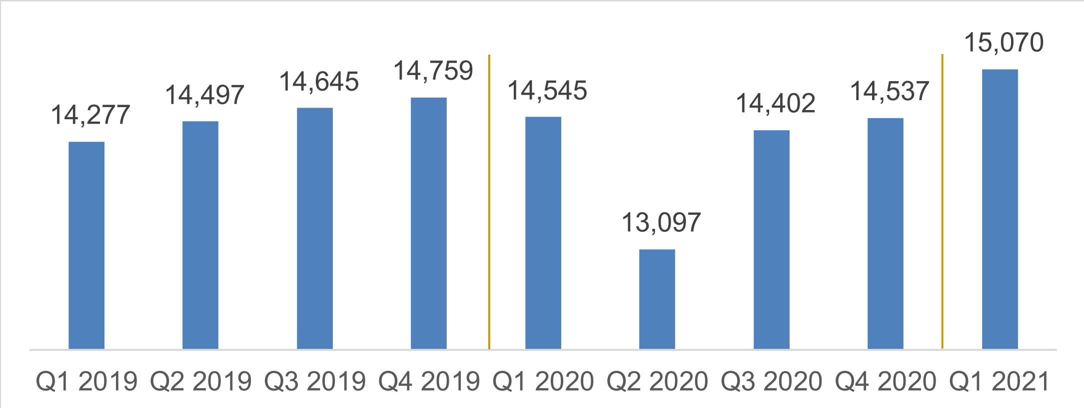
Such favorable growth in real GDP is led by the recovery in 17 out of 22 industry groups, particularly durable goods manufacturing (e.g., computer and electronic products, fabricated metal products, and machinery), and private services (e.g., professional, scientific, and technical services). Nevertheless, GDP growth was offset by a decrease in nondurable goods manufacturing (e.g., petroleum and coal products), agriculture, forestry, fishing and hunting, and healthcare, social assistance, and utilities.

Promising Personal Consumption

US Personal Consumption ("PCE") drives almost 70% of GDP and is an important indicator of economic growth because it reveals how much Americans are spending as opposed to saving. Spending is a driver for short term economic health, while saving is important for the long term. In 2019, American households spent $13.3 trillion. Before Covid-19, PCE increased by 4.0% Q-o-Q in Q4 2019, with 64% of PCE going to services, and was a key driver of GDP growth. Consumer spending significantly dropped in 2020 as a result of Covid-19. Savings, however, increased last year as even the employed population cut back spending considerably in light of economic uncertainty. The personal savings rate ended 2020 at 14.2%, nearly double the level in December 2019, and PCE contracted 3.9% last year compared to a 2.4% growth in 2019, which was a significant factor in the dramatic decrease in the GDP.

Spending did not surpass the pre-pandemic level of February 2020 until March 2021. In May 2021, PCE was unchanged M-o-M, following a 0.9% growth in April. An increase in spending for services, led by recreation services, food services and accommodations, as well as housing and utilities, was mostly offset by a decline in spending for durable goods, where a decrease in spending on motor vehicles and parts was the leading contributor.

US Personal Consumption Expenditure (In US$ Billions)



Source: MCG, Bureau of Economic Analysis, June 2021

The increase in PCE can be attributed to mass vaccinations and economic reopening, which have increased consumers' confidence to travel and resume many pre-Covid activities. Consumers are increasingly buying big-ticket items, such as vehicles and furniture, while there is also a shift to spending more on in-person services. Coupled with ample savings levels and fewer restrictions, spending on services should move toward pre-pandemic levels in the coming months. In the meantime, increase in demand, paired with supply bottlenecks and capacity constraints, put pressure on inflation.

Robust Business Investments

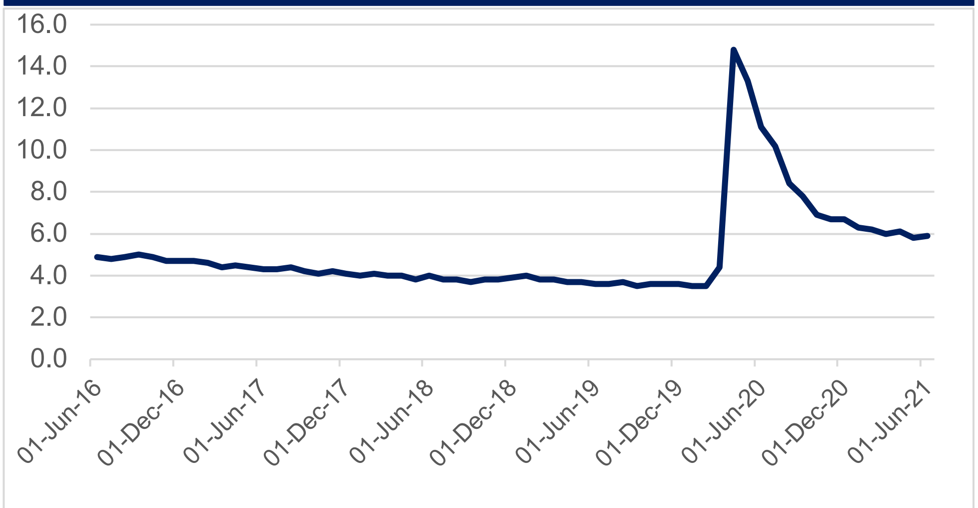
As the economy recovers and grows, business investments have increased as well, becoming a powerful force sustaining the economy's growth efforts. During the pandemic, nonresidential real estate investment was down 17% as the demand for office buildings and retail space collapsed with the shift towards remote working and a dramatic increase in ecommerce. Demand for retail space especially decreased for mom-and-pop businesses, as well as restaurants, because of lockdown mobility restrictions. However, the rate for nonresidential fixed investment has increased 11.7% in Q1 2021. There has also been a huge growth in machinery, technology, and software investments as companies are increasingly confident in the growth of the labor force and GDP. While Q1 2021 business investment was just slightly above the pre-pandemic level, with businesses hoping to expand their workforce, increase investment in PP&E, and bring employees back to the office, this rate of growth does not seem to be slowing soon. Investment in equipment increased 7.5% from the pre-pandemic level, most of which was purchases of information processing equipment, while investment in other equipment categories either rose modestly or—in the case of transportation equipment—fell.

Unemployment Drops as The U.S. Reopens

Arguably the most devastating effect the Covid-19 pandemic had on Americans was the drastic increase in unemployment. The sudden constriction of GDP, coupled with severe lockdown restrictions and the feeling of uncertainty in the country resulted in mass layoffs and lost job opportunities. Furthermore, many parents, particularly women, left the workforce to take care of their children and households after schools closed. The unemployment rate reached a record high of 14.8% in April 2020, the highest it has been since the Great Depression. The labor force participation rate decreased to 60.2%, the lowest it has been since the 1970's. As a result, the government created emergency unemployment benefit plans to help support Americans during this unprecedented time. The week of 8 May 2021,15.8 million people received unemployment benefits, which is four times the number of those who received benefits in 2014 when the unemployment rate was roughly the same. Many employers were scared that because of such comprehensive unemployment benefit programs, people would be less inclined to join the labor force and work again. However, most of these programs are set to stop by the end of 2021 and the number of Americans applying for unemployment benefits has reached its lowest level since the pandemic struck last year.

As the U.S. economy continues to recover and grow, unemployment shows signs that it will continue to decrease. According to the Bureau of Labor Statistics, both the 5.9% unemployment rate and the number of unemployed persons, at 9.5 million, were relatively stable M-o-M in June 2021. Overall, June's nonfarm payroll employment is up by 15.6 million since April 2020, but that amount is 6.8 million (or 4.4%) less than the pre-pandemic level in February 2020. Although the current statistic remains well above the pre-pandemic levels at 3.5% and 5.7 million, respectively, in February 2020, this is still a positive and reassuring decrease from pandemic levels of unemployment. Hopefully, as the economy continues to expand beyond pre-pandemic levels, unemployment will follow suit and continue to decrease.

US Unemployment Rate
(In Percent)



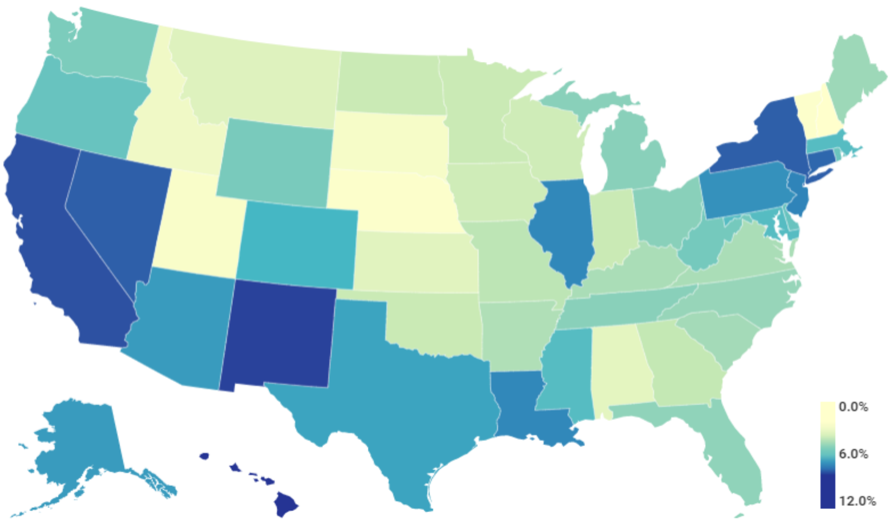
Source: MCG, Federal Reserve Economic Data, June 2021

Employment levels, right now, are experiencing a boom in the specific industries that Covid-19 restrictions hurt the most. These sectors, including leisure and hospitality, public and private education, professional and business services, retail trade, and other services sectors, had significant job gains in June. Employment in leisure and hospitality increased by 343,000 in June, over half of which was in food services, as people gain the ability to frequent restaurants, bars, and nightclubs, as well as travel.

As schools reopen and transition to become fully in person, school districts are preparing for the return of their students by increasing staff. Employment rose by 155,000 in municipal education, by 75,000 in state government education, and by 39,000 in private education. The reopening of schools also allows parents to rejoin the workforce because they are no longer to provide daily childcare. This may result in an increase in employment in professional and business services, which rose by 72,000 in temporary help services (+33,000), advertising and related services (+8,000), scientific research and development services (+7,000), and legal services (+6,000).

Stores relied on the growing ecommerce market to stay afloat when pandemic restrictions prevented in-person shopping. Now that in-person shopping has resumed, retail trade added 67,000 jobs in June, with employment growth in clothing and clothing accessories stores (+28,000), general merchandise stores (+25,000), miscellaneous store retailers (+13,000), and automobile dealers (+8,000), which was partially offset by losses in food and beverage stores (-13,000) and health and personal care stores (-7,000).

Unemployment Rates by US Geography



Source: MCG, Bureau of Labor Statistics, May 2021

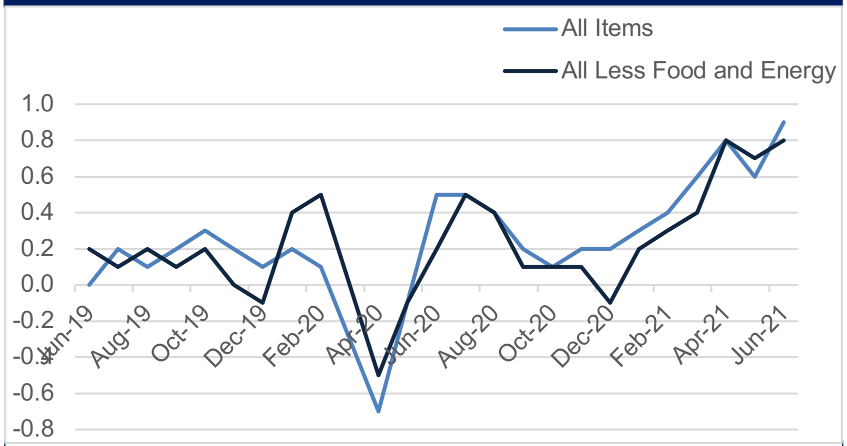
Nonfarm employment increased in 14 states, decreased in one state and was unchanged in 35 states and the District of Columbia from April to May 2021. Hawaii (8.1%), New Mexico (8.0%) and California (7.9%) had the highest unemployment rates in May.

The increase in job openings is due, in part, to businesses' response to the surge in consumers' demand. Because of the rollout of Covid-19 vaccines, which has sharply reduced new cases from a seven-day average of around 250,000 in early January 2021 to roughly 50,000 recently, people have increasingly spent time outside and are eager to pay for things they had missed during pandemic lockdowns. Businesses need extra help to satisfy this increase in demand, which gives workers more opportunities to rejoin the labor force. With overall job openings of a record 9.2 million in May, labor shortages in many industries are causing employers to raise wages and, in some cases, to raise prices to offset these higher labor costs.

Inflation Remains Stubborn

As the economy recovers, in many ways inflation is inevitable. The rate at which it is increasing, however, has raised concerns for many economists and consumers alike. The Consumer Price Index for all urban consumers ("CPI-U") increased 0.9% in June, after rising 0.6% in May, marking the largest 1-month change since June 2008 when the index rose 1.0%. On a year-on-year basis, the all-item index increased 5.4%, the largest increase since August 2008. The biggest price increases in consumer goods were recorded for used cars and trucks (45.2%), gasoline (45.1%), fuel oil (44.5%), utility gas service (15.6%) and transportation services (10.4%). The price for shelter increased 2.6% and food 2.4%.

US Monthly CPI-U
(In Percent)



Source: MCG, U.S. Bureau of Labor Statistics, June 2021

Inflation rates over the past 21 years have all been around or below 3.5%, so the jump to 5.4% in June 2021 is jarring and needs to be stabilized by the Fed. However, this jump is predicted to be temporary, as the "break-even inflation rate," which is the difference between the yield on regular Treasury bonds and on inflation-indexed bonds, over the next five years has dropped 0.19% since mid-May.

The core price index jumped 3.8% in May, which is the largest percent increase since June 1992. Many economists attribute this increase to a "summer boom" in which subsiding lockdown restrictions and government stimulus are causing consumers to spend more, which increases prices. Inflation, right now, is deemed transitory. High inflation means it is easier to pay off debt and gives workers more room to negotiate higher wages. However, it also decreases purchasing power, dwindles savings, and has the power to destabilize entire economies, as seen throughout history. The Fed, Chairman Powell says, is keeping a close look at inflation levels and is intent on picking the right time to tighten monetary policy in order to keep jobs and wage gains, but prevent massive, sustained inflation. Many assume once the effect of liberal fiscal policy on the economy become less powerful, inflation will decrease and restabilize.

Compared to other countries, the U.S. had a relatively low inflation rate of 1.2% in 2020. In Brazil and China, their inflation rates in 2020 were 2.73% and 2.92% respectively. While the Fed is still expecting inflation to level off at 2% at the end of 2021 or the beginning of 2022, it is still possible it could rise to 2.5% or 3%. If so, financial markets will need to reorient themselves because most of their projections are based on the Fed's inflation expectation. The Fed is comparing the current inflation to a spike that occurred from July 1946 to October 1948, where supply shortages and pent-up demand caused postwar inflation of more than 5%. This inflation declined when supply chains normalized, and demand plateaued. The Fed hopes the same will happen today.

Same Interest Rates

At its last meeting the Federal Open Market Committee ("FOMC") on 15–16 June 2021, decided to hold the target range for the policy interest rate at its effective floor of 0.00%–0.25%. The Fed also reaffirmed its commitment to promote "maximum employment and price stability." While noting a rise in inflation, the FOMC considers this to largely result from transitory factors and it maintains that it will pursue accommodative monetary policy if inflation averages 2% overtime, with long-term inflation expected to anchor at 2%. The Fed will also continue its program to increase its holdings of treasury securities and agency mortgage-backed securities by at least $80 billion and $40 billion per month, respectively.

Many expect the Fed to increase rates from the current rate around zero near the end of 2022, but implied rates in December 2023 have fallen to 0.69%. This is a decrease in the expectations of 0.81% in mid-May and 0.94% at the start of April. Also, U.S. interest rates are set to rise by only 1.46% by the end of 2026, compared to the rate of 2.32% traders predicted in April. The market is afraid of a full-on hiking cycle for rates since inflation is still not stabilized.

International Trade Resumes

International trade suffered on all fronts during the pandemic, as countries focused their resources internally to alleviate the effects of Covid-19 on their own populations. As a result, factories shutdown, which harmed product outputs and supply chains, and consumers decreased their spending, reducing demand. In 2021, manufacturing and shipping costs have increased, as have consumer prices, due to the global recession and recovery efforts around the world. In addition, in March, about $60 billion worth of trade was jeopardized by the "traffic jam" in the Suez Canal, and further strained international trade.

In the U.S., exports dropped over 2019-2020 mainly because of the U.S.-China trade war tensions, particularly the high tariffs enacted by the Trump Administration, the appreciation of the U.S. dollar, and the same factors that affected all international trade (i.e., demand and supply-chain disruptions caused by the Covid-19 pandemic).

While there has been increasing political tension between the U.S. and China, there have been efforts to heal economic relations between the two countries. Bilateral trade between them in

2021 has increased beyond pre-pandemic levels, mainly because of the trade agreement signed in 2020, which required China to buy $200 billion worth of U.S. goods. The U.S. trade deficit with China has decreased by about 33% from its peak in 2018 ($419 billion) to $284 billion in 2021. China is set to purchase millions of dollars farm goods from the U.S., and U.S. consumers, supported by a growing economy and a hefty stimulus package, purchased $46.9 billion worth of Chinese exports in June 2021. U.S. consumers' demand for Chinese manufactured goods remains high because of the steady increase in international ecommerce.

However, there are still high tariffs on $370 billion worth of Chinese goods, and U.S. companies are squeezing either profit margins to take on these costs or transferring it to consumers. The Biden Administration signed an executive order to analyze the global supply chains associated with computer chips, large-capacity electric vehicle batteries, pharmaceuticals, and critical minerals in electronics. This is because the semi-conductor industry faced large bottlenecks when Covid-19 lockdowns shut down production factories in China. The Administration is looking to make U.S. supply chains not only more self-reliant, but also less reliant on China. U.S. imports increased 33.7% between June 2020 and March 2021 to bolster economic growth in U.S. production, yet there was only a 6.9% increase in U.S. imports from China during the same time period. The U.S. is diversifying its imports not only because of China's breech of supply-line security, but also because of increased labor costs that make emerging markets more attractive.

The balance of trade between China and the U.S. is slowly becoming more equal, but one must question whether this is because of strategic trade agreements or the natural ebb and flow of economic cycles, which are also influenced by global events. Both countries rely on each other economically, as does the entire world, so a positive trade relationship can only boost both economies.

As more countries' economies start to recover, trade negotiations have resumed for U.S. trade with China is extremely important because it is the U.S.'s largest trading partner, and the countries have the two largest economies in the world. However, the U.S. has also made sure to revisit and strengthen its trade deals with Brazil. As China purchases more of the U.S.'s agricultural products, the U.S. has increased its imports of Brazilian beef and pork, making it the third largest consumer of Brazilian meat exports. Tensions between the U.S. and China strains the U.S.'s trade relationship with Brazil because Brazil is much more dependent on China and its importation of Brazilian products. However, most politicians in Brazil are keen on keeping both relationships strong while their economy is stagnant, meaning the U.S. will still have a foothold in the largest South American economy.

The U.S. is still navigating how to continue its positive trade relationship with the U.K. after Brexit. Negotiations on trade agreements were put on hold for all parties involved, the U.K., EU, and U.S., during the pandemic. Yet, even without a finalized trade deal between the U.K. and the EU, U.S. businesses with operations in the U.K. plan to increase investment there over the next couple years. The U.K. remains an attractive place for the U.S. to do business because of its position in advanced technology and professional service sectors. While the negotiation of a trade deal would increase U.S. and global confidence in doing business with the U.K., many U.S. businesses still believe in their strong economy.

GENERAL OBSERVATIONS

COVID-19 MUTATIONS THREATEN RECOVERY

As of July 2021, the U.S. has a 49% full vaccination rate and recorded a 1-week average of about 50,000 new cases per day. According to data from Johns Hopkins University, cases are rising in all 50 states and Washington, D.C., with the average new cases at least 10% higher than a week ago, and 38 states are seeing at least a 50% increase. The communities most at risk are those with low vaccination rates. Among those states that have less than 50% fully vaccination rate, the average Covid-19 case rate was 11 new cases per 100,000 people last week, versus 4 per 100,000 among states that have over 50% fully vaccination rate. An average of about 343,000 people are becoming vaccinated each day, 25% slower than the rate two months ago, when more than 1.3 million people were vaccinated each day.

The risk is fueled by the spread of the Delta variant, first identified in India and first detected in the U.S. in March 2021. Delta variant cases now make up more than 50% of Covid-19 cases in the US. In some areas, it is greater than 70% as the Delta variant mostly affects people who are unvaccinated or only partially vaccinated. The Alpha variant (British variant), which once made up more than two-thirds of new Covid-19 cases in the United States, now accounts for less than one-third of cases, being replaced by more contagious Delta variant.

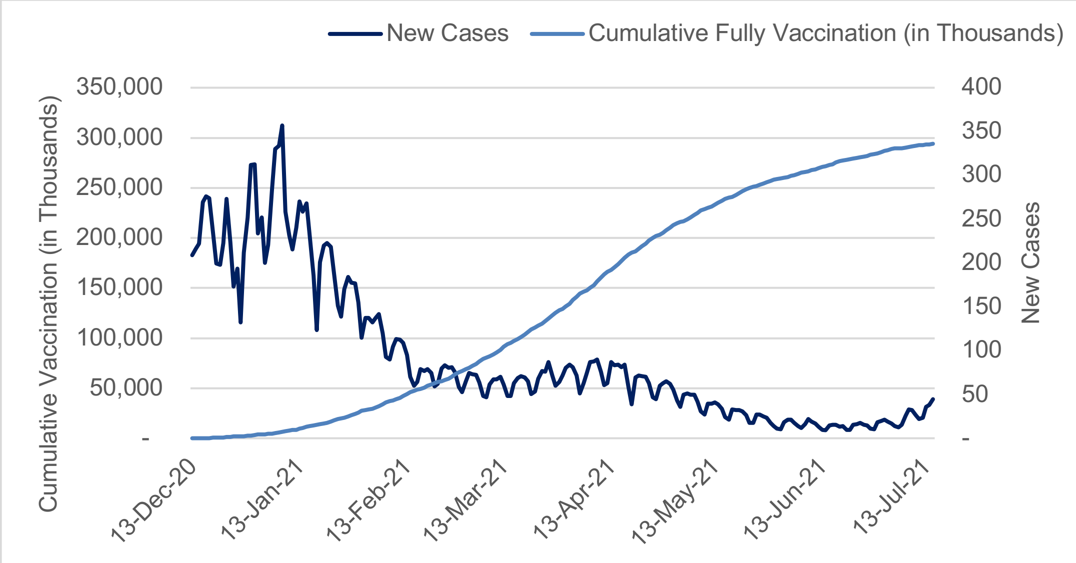
The Delta variant poses a threat to the rising hope of returning to normal. While economists predicted a “Roaring Twenties” period of economic growth and increased consumer spending after the recession caused by Covid-19, the rise in cases, coupled with the plateau in vaccination rates, is causing investors and consumers to lose this rosy view. Hospitalizations from Covid-19 in the U.S. have risen by 50% in the last two weeks. Most economists, however, are expecting there to still be robust growth in GDP in the second half of 2021 because it is unlikely that another lockdown will be instated.

Before the outbreak of the Delta variant, the Fed predicted a 10% growth in GDP in May, however, that number has been reduced to 7.6%. While this is still a positive indicator of economic recovery and growth, it is more conservative than the original predictions of the U.S. economy's bounce back. Employment is expected to increase by more than 500,000 per month on average and many people, especially women, are expected to join the labor force once schools open. Since most of the states being affected most by Delta variant Covid-19 cases are those with a small and older population that do not contribute much to the GDP of the country, it is reasonable to assume the continuation of a bullish second half of the year. If a more deadly and more contagious mutation were to arise, however, that could pose a serious threat to the economic recovery and growth anticipated. The best way to ensure economic growth at this point would be to continue vaccination rollouts and encourage businesses and consumers to follow precautionary health procedures, such as wearing a mask indoors.

There is serious concern on whether the Delta variant will bottleneck supply chains in emerging markets, which do not have the infrastructure, medical or economic, to control such large outbreaks. Columbia, Peru, Thailand, South Africa, and The Philippines are considered emerging markets that are at the most threat to the Delta variant, as they all have low vaccination rates. While the Delta variant may have lower death or hospitalization rates, there is not a healthcare system in place that can handle such a large spread of Covid-19, which will result in governments having no choice but to re-impose mobility restrictions. Peru reported a new Lambda variant of Covid-19 to the WHO, which highlights the possibility that the outbreak of the Delta variant could mean the outbreak of another deadlier and vaccine-resistant variant that could halt the global economy's recovery. The Delta variant outbreak further exemplifies the importance of vaccine-sharing initiatives, like COVAX, to insure global economic recovery, regrowth, and stability.

There is also concern that the Gamma variant, first found in Brazil and first detected in the U.S. in January 2021, will create a new, strong mutated strain because of its contagiousness. In Illinois, which has a 48.1% full vaccination rate, out of the 10,886 cases recorded on 26 July 2021, 6,973 of them were caused by the Alpha variant, 2,641 cases by the Gamma variant, and 636 by the Delta variant. The CDC has reinstated in mask mandate in schools K-12 as of 27 July 2021, which suggests that the "summer bubble" soon will pop. Covid-19 will keep mutating well into 2022, which may decrease travel and person expenditures, but will probably have little effect on the growth of the economy. Once lockdowns and restrictions are lifted, it is nearly impossible to reimpose such limitations on daily life. Businesses will continue to function under the "new normal" and life will go on. Many predict like colleges, federal agencies and businesses will require workers to be vaccinated to go back to the office. This will hopefully have positive effects on the vaccination rate, which may significantly slow down the incidences of mutations.

US Covid-19 Vaccination and New Cases Comparison



Source: MCG, Centers for Disease Control and Prevention, July 2021

FISCAL POLICY

Substantial fiscal stimulus is expected to lead to substantial public debt in the US over the short to medium term. The main increase in government expenditure in 2020 has been attributed to the $2.3 trillion Coronavirus Aid, Relief and Economy Security Act (equivalent to around 11.0% of GDP), which aims to provide financial support for employees, households, and small businesses and preserve jobs. In March 2021, the House passed another $1.9 trillion Covid-19 relief package, known as the American Rescue Plan, set to send $1,400 checks to most Americans, extend unemployment insurance and allocate billions of dollars for coronavirus testing. It is among the largest economic stimulus packages in U.S. history.

While U.S. GDP grew 6.4% in Q1 2021, reflecting reopening of establishments, and continued government response to the Covid-19, the US's public-debt-to-GDP ratio is projected to be higher than it was during the Second World War, making it one of the key concerns for the newly elected administration. Public debt rose by 23% point and reach 131% of GDP in 2020, while, after the Second World War, public debt to GDP reached only 121% - significantly below current levels. Substantial public debt could be a catalyst for the Fed to accept higher inflation rates in the future and, thus, sustain future GDP growth.

The Federal government is also using an antitrust executive order to encourage growth in the economy, especially in the technology, finance, and healthcare sectors, by increasing competition. The lack of competition in these sectors, because of data collection, corporate consolidation, and patent laws, has costed the average American household $5,000 per year and decreased advertised wages by 17%. The new proposed legislation will not only break down barriers to enter some of these industries, promoting the creation of more small businesses to increase competition, but also help the average American save and make more money.

PROSPECTIVE ECONOMIC OUTLOOK

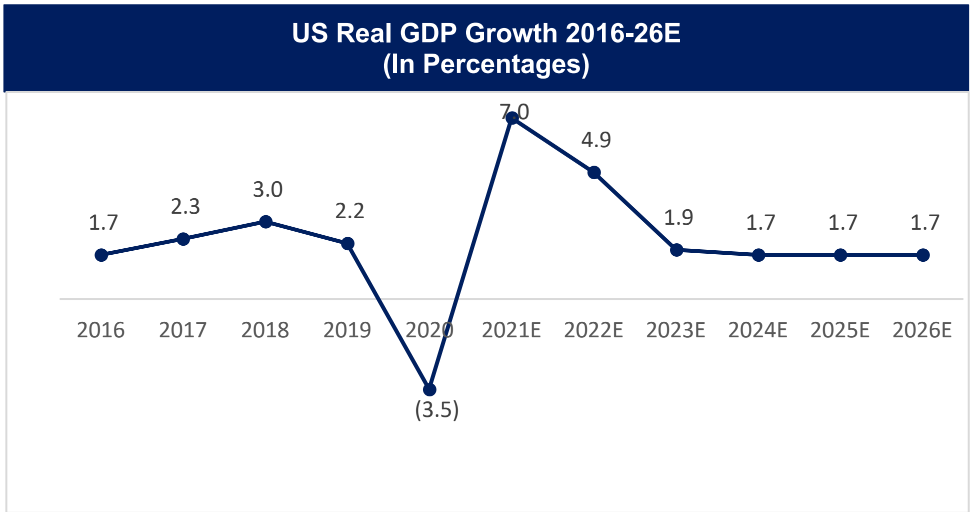
The 2020 COVID-19 recession shock has left lasting scars on the economy: persistently high long-term unemployment may post concern on individual's vocational skill and incentives for job seeking, impacting economic efficiency. According to U.S. Bureau of Labor Statistics, a sustainable annual GDP growth exceeding 3%, as experienced in the mid-to-late 1990s and mid-2000s, is not expected over the coming decade. In addition, a tight debt-to-GDP ratio, which rose from 108% in 2019 to 131% in 2020 and restrained investment during the recession, could hinder long-term growth prospects.

The unprecedented fiscal and monetary policies, coupled with declining Covid-19 cases, are expected to substantially boost U.S. economic activity in the coming months. Savings will be increasingly drawn down, demand for in-person services will recover, and depleted inventories will be replenished. According to the IMF, the U.S. is expected to record around 7% GDP growth in 2021, the fastest pace in a decade. This strong economic performance is likely to continue into 2022, with projected growth of around 5%, assuming that the American Jobs Plan and American Families Plan is put into action as proposed in 2022. There is some uncertainty of the plan's long-term effects. It is unclear whether the boost of public infrastructure investment will boost the productivity of private capital and labor such that it outweighs the additional government borrowing to finance such a project. The Penn Wharton Budget Model predicts that such an investment, will increase public capital by 4.6%, decrease private capital by 0.8% in 2040, with a zero net effect on GDP by 2040.

Continuing labor market slack could help lesson wage and price pressures. While inflation is expected to be well-anchored, short-term underlying inflation trends will be obscured by significant, transitory movements in relative prices which could lead core personal consumption expenditure (PCE) inflation to temporarily peak later in the year (around Q4 2021), before tapering down to around 2.5% by end of 2022 after temporary price realignments have passed through the system. If inflation continues to rise, there will be devastating destabilizing effects on the economy. The Fed needs to act soon in order to tighten interest rates and the money supply to ensure this does not happen. While high inflation can be sustained for a little while, for there to be continued economic growth the next decade, the inflation rate needs to be capped below 2.5%.

The biggest challenges employers will face in the coming months will be finding a balance between in-person office work and flexible work-from-home options, deciding whether to require employees to be vaccinated/share their vaccination status, and the uncertainty of the resurgence of mutations of Covid-19, which could wreak havoc on the economy. Employees in certain industries, especially millennial-aged employees, have grown comfortable with the flexibility of remote working and appreciate the time saved from commuting to the office. Employers, however, want to bring employees back to the office to increase production, collaboration, and lower moral hazards. Moreover, to ensure the safety of employees, employers are faced with the options of requiring vaccinations or weekly Covid-19 testing. Depending on the state in which they operate, this could create backlash from employees that would stifle the labor market. Yet, because of the uncertainty of mutation and spread of more variants, this may be the only viable way to resume in-person work at a higher capacity any time soon.

To further protect the purchasing power of consumers, core PCE inflation needs to also be decreased. Demand for consumer goods is high and it is boosting the economy, but it cannot be sustained at its current prices. Travel fare, concert fare, and restaurants are inflated because these sectors lost business during the pandemic, which they need to recover from, and consumers want to enjoy experiences they had foregone during the pandemic.



Source: MCG, IMF, June 2021

In addition, below table shows FOMC economic projections for 2021 from 15-16 June 2021 FOMC meeting.

Economic Variable	Median Projection *(as of July 2021)*
Real GDP Growth	7.00%
Unemployment Rate	4.50%
Personal Consumption Expenditures (PCE) Inflation	3.40%

The Federal Reserve expected real GDP to grow 7.0% in 2021, compared with the 6.5% forecast from its March meeting. The Fed also sharply increased its inflation forecasts for the year to 3.4% this year, above its previous estimate of 2.4%, citing that the spike in prices is largely being driven by pandemic-related issues- the abnormal rise in the price of lumber and used vehicles, so inflation is expected to move down. The Fed still estimates the unemployment rate to be unchanged at 4.5% in 2021. The Fed also indicated the first interest rate hike may come in 2023, rather than 2024, as it indicated in March.

What does this mean for the U.S. economy? Most people are tired of instability and want to keep having a positive economic outlook. While there are support systems in place that continue to help the economy bounce back and enter a growth stage, these systems increase inflation and may have destabilizing affects in the future. As of right now, the size and strength of the economic recovery, as well as its lasting effects, remains uncertain. If new mutations of Covid-19 appear that are highly contagious and vaccine-resistant, the efforts to make an economic comeback might not even matter because lockdowns, supply chain shortages, and a dwindling population will reverse them. However, as seen in similar historical examples, the U.S. economy tends to rise from the ashes better than before. Hope for sustained economic growth, decreased unemployment, and stabilized inflation is not unfounded and is likely to be realized.

[1] Sources: from various sources—M Capital Group Research, including data from "Unemployment Rates During The COVID-19 Pandemic" Congressional Research Service, June 2021; "The Employment Situation" Bureau of Labor Statistics, June 2021; "Executive Order on Promoting Competition in the American Economy" The White House, July 2021; "President Biden Announces Support for the Bipartisan Infrastructure Framework" The White House, June 2021; "Capital-Spending Surge Further Lifts Economic Recovery" The Wall Street Journal, June 2021; "More Jobless Getting Aid Than in Past Even as Cutoff Looms" Associated Press News, May 2021; "Brazil Beef Exports to U.S. Rise Amid China-Australia Trade Spat" Reuters, July 2021; "How Will Brazil Navigate the U.S.-China Rivalry" Americas Quarterly, July 2021; "Gross Domestic Product, Second Quarter 2021 (Advanced Estimate) and Annual Update" U.S. Bureau of Economic Analysis, July 2021; "Suez Canal Traffic Jam Caused By Stuck Ship Ever Given 'Cleared'" BBC News, April 2021; "U.S. Inflation is Highest in 13 Years as Prices Surge 5%" The Wall Street Journal, June 2021; "Delta Variant's Surge Brings New Uncertainty to the Economic Recovery" CNBC, July 2021; "Delta Variant Create Emerging Market Gap as Outperformers Hit" Bloomberg, July 2021; "U.S.-China Goods Trade Booms as if Virus Tariffs Never Happened" Bloomberg, July 2021; "The Fed's Favorite Price Index Rose 4 Percent. What Comes Next?" The New York Times, July 2021.

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